THE RECORD
OF THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK

EDITORIAL BOARD

DUDLEY B. BONSAL, *President* — PAUL B. DE WITT, *Executive Secretary* — HAROLD H. HEALY, JR., *Secretary*

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Association Activities

THE COMMITTEE on Entertainment, Eugene A. Leiman, Chairman, has announced that the President's Ball will be held on Friday, May 13, at nine thirty at the House of Association with music by Ben Cutler. The Ball will honor the retiring President of the Association, Dudley B. Bonsal, and Mrs. Bonsal. Former Presidents of the Association have joined the Entertainment Committee in sponsoring the event. Alan U. Schwartz is Chairman of the Subcommittee in charge of arrangements.

THE ANNUAL Art Exhibition sponsored by the Committee on Art, Edmund T. Delaney, Chairman, opened with a very well attended reception. Chairman of the Subcommittee in charge of the show was Samuel Ross Ballin and Lloyd Goodrich, Director of the Whitney Museum of American Art, acted as Consultant.

THE FOLLOWING symposia have been sponsored during the past month:

"Mental Disorder and Abnormality, Criminal Behavior and Criminal Responsibility" by the Committee on Medical Juris-

prudence, Morris Ploscowe, Chairman. This symposium was an all-day session and had as its speakers Dr. Ralph Brancale, Director, New Jersey State Diagnostic Center, Menlo Park; Whitman Knapp, Esq., former Assistant District Attorney and Head of Appeals Bureau, New York County District Attorney's Office; Herbert Wechsler, Esq., Professor of Law, Columbia University School of Law, and Chief Reporter, Model Penal Code of The American Law Institute; Dr. Morris Herman, Professor of Psychiatry, New York University School of Medicine; Abe Krash, Esq., Member, District of Columbia Bar; and Morris Ploscowe, Esq., former Magistrate and Adjunct Associate Professor of Law, New York University.

"Soviet Law and East-West Trade" was the subject of a lecture and panel discussion sponsored by the Committee on Foreign Law, James G. Johnson, Jr., Chairman. Speakers were Harold J. Berman, Professor of Law, Harvard Law School; Leon S. Lipson, Professor of Law, Yale Law School; and Isaac Shapiro, Member of the Committee on Foreign Law.

A joint meeting of the Section on Banking, Corporation and Business Law, John R. Raben, Chairman, and the Special Committee on Banking Law of the Federal Bar Association of New York, New Jersey and Connecticut, Otto Crouse, Chairman, was devoted to a lecture by Richard S. Simmons, Esq., Deputy Superintendent and Counsel, Banking Department, State of New York. Mr. Simmons' topic was "Bank Holding Companies and Branch Banking Under the New Omnibus Banking Act."

Richard J. Turk, Jr. spoke before the Section on Wills, Trusts and Estates, Joel Irving Friedman, Chairman, on "Powers of Appointment." Edward R. Finch, Jr. at the same meeting reviewed recent decisions.

THE COMMITTEE on Criminal Courts, Law and Procedure, Arthur H. Christy, Chairman, on April 21 held a reception for the Justices of the Court of Special Sessions and the City Magistrates.

Following the reception Chief Justice John M. Murtagh and Chief City Magistrate Abraham M. Bloch spoke briefly.

THE FOLLOWING statement is published at the request of Hilda G. Schwartz, Treasurer of the City of New York:

The New York City General Business and Financial Tax for the Calendar Year 1959 is due and payable on or before May 15, 1960.

The General Business Tax is imposed for the privilege of carrying on or exercising for gain or profit within the City of New York any trade, business, profession, vocation or commercial activity (other than a financial business), or of making sales within the city. The rate of the tax is two-fifths of one per cent (⅔ of 1%) upon all gross receipts in excess of $10,000 received in and/or allocated to the City of New York for the base period covered by the return. Pursuant to a 1959 amendment, the first $10,000 of gross receipts may be deducted in computing the tax due. The practice of a profession is subject to the New York City General Business Tax, including lawyers, doctors, dentists, accountants, engineers, architects and others.

The New York City Financial Tax is imposed for the privilege of carrying on or exercising for gain or profit within the City of New York a financial business (as defined in Chapter 46, Title B, of the Administrative Code of the City of New York). Every person so engaged shall pay an excise tax of one and one-half per cent (1½%) upon all gross income in excess of $5,000 received in and/or allocable to the City of New York for the base period covered by the return.

Tax Returns should be filed on or before the due date, at the offices of the Department of Finance, Bureau of City Collections, in the borough in which the business or professional office is located. Assistance in the preparation of tax returns may be obtained at the offices of the Department of Finance, Bureau of City Collections.

LOCATIONS OF BOROUGH OFFICES OF THE BUREAU OF CITY COLLECTIONS

MANHATTAN	50 Pine Street, New York 5, N. Y.
THE BRONX	Tremont and Arthur Aves., New York 57, N. Y.
BROOKLYN	Room 1, Municipal Building, Brooklyn 1, N. Y.
QUEENS	Borough Hall, Kew Gardens 24, N. Y.
RICHMOND	Borough Hall, St. George, Staten Island 1, N. Y.

The New York City Occupancy Tax Return accompanies all Business Tax Returns. The Occupancy Tax is payable by persons who occupy space for

gainful purposes for a period of one month or more prior to July 15, 1960. The rate is one dollar ($1.00) per thousand of rental value up to $6,000. The Occupancy Tax is payable on or before July 15, 1960.

THE JUDICIAL CONFERENCE of the State of New York has asked that the following notice be published:

On September 1, 1960 any notice of pendency of an action filed prior to September 1, 1957 shall expire and shall no longer be effective notice. This is pursuant to Section 121-a of the Civil Practice Act which was enacted by the 1957 Legislature of the State of New York and which section became effective on September 1, 1957. Section 121-a also provides that all notices of pendency shall be effective as notice for a period of 3 years from the date of filing unless the period of duration of the notice of pendency has been extended by the court.

The text of the section is as follows:

"§121-a. Duration of notice. A notice of pendency hereafter filed shall be effective as notice for a period of three years from the date of filing. Before expiration of the period, the court upon application of the plaintiff and upon such notice as may be directed or approved by the court, and for good cause shown, may from time to time grant additional orders each extending the period of duration of the notice of pendency for a period of not more than three years. If extended, a copy of the notice stating the date of filing of the immediately preceding notice, and stamped or marked 'extended,' shall be filed, recorded and indexed prior to the expiration of the notice of pendency then in force in the manner prescribed in this article.

"A notice of pendency heretofore filed shall be effective for a period of three years from the effective date of this chapter, and shall be subject to extension as herein prescribed."

The Calendar of the Association for May and June

(as of April 29, 1960)

May	2	Dinner Meeting of Committee on Professional Ethics Dinner Meeting of Committee on Medical Jurisprudence Dinner Meeting of Committee on the Municipal Court of the City of New York
May	4	Dinner Meeting of Executive Committee
May	5	Meeting of Section on Wills, Trusts and Estates
May	10	*Annual Meeting of Association*
May	11	Dinner Meeting of Committee on Federal Legislation Dinner Meeting of Committee on the Bill of Rights
May	12	Dinner Meeting of Committee on Legal Aid
May	13	*The Association Ball*—Sponsorship Entertainment Committee
May	16	Meeting of Library Committee
May	17	Dinner Meeting of Committee on Aeronautics Dinner Meeting of Committee on Courts of Superior Jurisdiction Dinner Meeting of Committee on Administrative Law Symposium: Committee on Arbitration
May	18	Meeting of Committee on Admissions Dinner Meeting of Committee on Trade Marks and Unfair Competition Dinner Meeting of Committee on Foreign Law Dinner Meeting of Committee on Municipal Affairs Meeting of Section on Taxation
May	19	Symposium: Committee on Medical Jurisprudence
May	24	Meeting of Committee on Domestic Relations Court
May	25	Dinner Meeting of Committee on International Law

June 2 Meeting of Special Committee on the Study of Commitment Procedures

June 6 Dinner Meeting of Committee on Professional Ethics

June 8 Dinner Meeting of Executive Committee
Dinner Meeting of Committee on Federal Legislation
Dinner Meeting of Committee on the Bill of Rights

June 9 Meeting of Committee on Trade Regulation
Meeting of Section on Trade Regulation

June 15 Meeting of Committee on Admissions

June 17 Meeting of Special Committee on Study of Commitment Procedures

June 21 Dinner Meeting of Committee on Administrative Law

The President's Letter

To the Members of the Association:

This is the last letter which it will be my privilege to write you as President of the Association. I am glad to report that our Association continues to grow in numbers and, more importantly, in stature. Credit for this goes to you, the members, and to our staff. You have participated in our membership meetings and the numerous forums which have been held at the House of the Association. You make up our Committees, and many of these have brought great credit to the Association and to the organized bar. With your help my successor will continue to develop our program in the compass of the fine traditions which are our heritage.

It cannot be repeated too often that an important measure of our performance is our staff. This fine group of devoted people continues to serve your best interests. To them and to you, my thanks.

I have had a thrilling and unforgettable experience, for which I am grateful.

DUDLEY B. BONSAL

April 19, 1960

Legal Problems of the European Common Market

By MICHEL GAUDET

Ten months have gone by since I had the privilege of meeting here some members of the Committee on Foreign Law of The Association of the Bar of the City of New York. During this period events have happened on both sides, all emphasizing the vitality of the European Common Market.

Indeed, the above-mentioned Committee has published, in the October 1959 issue of THE RECORD of The Association of the Bar of the City of New York, a report on the European Economic Community, for which I wish to express my full appreciation. This accurate analysis of the legal aspects of the Common Market makes my speech useless for many of you. It is at least a reason for avoiding any systematic description of the objectives and of the legal system of the Community.

On the Community side, important steps have been or are being made for the execution of the Common Market Treaty. While 1957 has been the year of the conclusion of the Treaty, and 1958 that of a preparation as regards both the Member-States and the common institutions, 1959 has been the first year of action within the Community.

How do things stand as we enter 1960?

THE COMMUNITY IN THE EARLY 1960

1. The *organization* of the Community is almost completed. The four Institutions, e.g. the European Parliamentary Assembly, the Court of Justice of the Communities, the Council of

Editor's Note: The paper published here was delivered at a symposium sponsored by the Committees on Foreign Law and Trade Regulation and the Section on Trade Regulation, as well as by The Federal Bar Association of New York, New Jersey and Connecticut. Mr. Gaudet is Director General, Joint Legal Service, European Community.

Ministers and, last but not least, the Commission, are at work. They have acquired some experience and defined their methods of work. Their internal regulations have been adopted and published as far as the Assembly and the Court are concerned. Some more experience has been thought necessary before the Council and the Commission lay down and publish detailed rules for their own internal regulations.

The advisory Committees consisting of businessmen, trade-unions representatives and experts provided for in the Treaty have been set up. The Economic and Social Committee, as well as the Monetary Committee and the Transportation Committee have already been giving thoroughly studied and influential opinions on matters submitted to them by the Commission or the Council. The Commission has required such opinions not only when so prescribed by the Treaty but also in other cases where the advice of business and labour representatives as well as of highly qualified experts proved useful.

Special Funds provided for in the Treaty have been or are being established. After a year's consultation with the Economic and Social Committee and the Parliamentary Assembly, the Commission has submitted to the Council a proposed regulation implementing the Treaty provisions setting up a Social Fund to help unemployed workers to get a new job—and have more mobility of manpower. The Overseas Territories Investment Fund has been already allocating financial help for projected economic or social investments within the African territories.

During this same period, the European Investment Bank, also set up by the Treaty but as an independent body contributing by usual banking means to investments of common interest for the harmonious development of the Common Market, has also been organized and has begun to function. Loans have been granted for the realization of economic investments mainly in the underdeveloped areas of the South of Italy.

A few more regulations, presently under examination, have to be adopted to fix the final budgetary rules implementing the provisions of the Treaty. But the main lines have already been

determined in the transitional regulations applied to the two first budgets, and the special financial control Committee provided for in the Treaty is appointed and at work.

By and large, the institutional and administrative machinery of the Community is set up, providing the necessary means for action.

2. At the present stage, *action* lies mainly with the *common institutions* and the *national governments* of the Member-States. These States must comply with their obligations under the Treaty, while the common institutions must lay down regulations or directives implementing the provisions of the Treaty and elaborate a common policy.

a. On the whole, *the national governments have complied with their obligations* in a remarkable way. On January 1st, 1959, tariffs have been reduced by an average 10%; each member-country has set one single quota open indiscriminately to the other five partners of the Community instead of five separate quotas. Negotiations to achieve setting up the further common external tariff are going faster than was ever hoped for when the Treaty was drafted. Prohibited subsidies have been removed; traditional public monopolies are being adjusted in order to make gradually possible a free circulation of goods within the Common Market.

In the very few cases, of little economic significance, where infringements have been noticed, the Commission has made representations to the Governments concerned, which up to now have complied, without even proceedings before the Court of Justice being necessary. In a few more cases, the interpretation of the Treaty as to the obligations of the Member-States has proved doubtful. The Commission has elaborated an interpretation and made it known to the Governments concerned. Two or three reasoned opinions have been given by the Commission. Up to now, the Governments have accepted the Commission's interpretation. Some of these cases are still under examination by the Commission, and may lead to reasoned opinions which might eventually result in proceedings before the Court of Justice.

b. According to the Treaty, common institutions have *to adopt*

regulations to implement the provisions of the Treaty. Preliminary studies and consultations have proved necessary. As they are completed, appropriate measures have or will be taken by the competent institutions.

Thus, the Commission has issued a regulation (provided for in article 10 of the Treaty) concerning the circulation within the Common Market of goods originating in a Member-State in whose manufacture products have been used free of duties of equivalent charges.

The Commission has also proposed to the Council a regulation (provided for in article 79) aiming at the removal of specific discriminations in transportation within the Community. A decision of the Council is expected shortly. The Commission is at work on the regulations that should be proposed to the Council (accordingly with the provisions of article 87) in order to implement the antitrust rules of the Treaty.

With a different procedure, the common institutions must fix an appropriate program to eliminate discriminations and, to a certain extent, ensure freedom within the Common Market as regards right of establishment, services and movement of capital and labour. The right of establishment in the Common Market will mean the freedom for individuals and enterprises belonging to one Member-State to establish themselves and exercise their professional activity in another Member-State under the same condition as the initials of that Member-State. Already in 1958, the Council acting on the proposal of the Commission has (in a regulation provided for in article 51) determined a system of social security which gives to migrant workers and to their families at least the advantages to which they are entitled in their own country. The Council has recently adopted directives addressed to the Member-States concerning the elimination of discriminatory rules for the establishment of nationals of the Member-States in the overseas territories. The Commission will shortly submit to the Council (accordingly with article 54) a program for the elimination of discriminations in the right of establishment within the Member States of individuals and enterprises. A program

for the freedom of services will follow. The Commission will shortly submit to the Council proposed directives concerning a first step in the freedom of movement of capital within the Community.

As you see, in the year 1960 a number of important regulations should be issued and/or basic programs adopted, as a result of the preliminary studies and consultations of the past two years.

c. Last but not least, the common institutions are bound by the Treaty to *elaborate a common policy* in broad economic fields.

From the start, the Commission has set at work on two basic questions: the commercial policy and the agricultural policy of the Community. Action has to be taken almost every month, if not week, in accordance with the international situation as regards the commercial policy. But as far as agriculture is concerned, it is a long-term program that has to be elaborated. Modernization of the agricultural enterprises, marketing organization for basic products, keeping a balance between agriculture and industry as well as between production and importation—these problems had to be analyzed for the first time within the six Countries considered as a whole. A gradual harmonization of national structures and national programs will be necessary.

Less than two years after its appointment, the Commission has submitted to the Economic and Social Committee and to the Assembly for advisory opinion, and to the Council for final decision, a complete program of agricultural policy which is already under close examination and may prove to be one of the main issues of 1960.

At the same time, besides long-term studies on a transportation policy, the Commission has started to elaborate the elements of a concerted if not common policy of the Member-States in financial economic matters. On the proposal of the Commission, the Council has decided, two weeks ago, to create an advisory board to assist the Commission in all matters of common short-term policy.

d. This brief survey explains why, as said before, action lies at the present stage with the common institutions and national

governments. They must continue to create the conditions and to define many of the rules of the Common Market, in which the enterprises will develop their activity.

But to conclude that business is actually pursuing a waiting game would be misleading. *Business has anticipated the realization of the common market,* the gradual achievement of which it already takes for granted. Businessmen have realized that their own attitude would influence the governments and institutions to move on. And in fact, the attitude of business, whether it be agriculture or industry, inside the Community or outside, has been changing at a rate which promoters of the Common Market themselves had never foreseen. Since the past year, businessmen while making plans for their development and their commercial activity are assuming the near realization of a real common market.

This situation has led business and governments, as well as the common institutions, to contemplate hastening the establishment of the common market. A transitional period of twelve, or at the utmost fifteen, years has been set by the Treaty to take gradually all the measures necessary for establishing the Common Market. Three years ago when the Treaty was discussed this period seemed too short; it is today considered to be too long. This is a concrete sign of the new attitude vis-à-vis the Common Market. The Commission is presently studying proposals, to be submitted to the Council, in order to speed up the gradual process of establishment of the Common Market.

THE COMMON MARKET

The steps that have been and are being taken in the European Economic Community show what its aims are. Economic integration is more than a mere trade agreement removing tariffs and quotas in interstate commerce. Indeed, the reasons of protectionism must themselves be removed. Otherwise, differences in economic structures and policies will lead enterprises and governments to find new remedies against free competition—and these

remedies, more or less disguised, can only be worse than openly discussed tariffs and quotas.

Economic integration means a gradual harmonization of economic structures and the adoption of a common economic policy. Not only tariffs and quotas must be removed, but also private practices and public regulations affecting interstate commerce. Common economic rules must be applied, on equal basis, throughout the Community with a view of creating conditions for a fair competition. Moreover, a common policy must be followed in basic economic fields.

THE COMMON INSTITUTIONS

Laying down common rules and leading a common policy is truly governmental work, and has to be made by common institutions in which each Member-State can have confidence. How does the institutional pattern set up by the Treaty work after two years experience?

The Commission, a board of nine members appointed with unanimous consent of the six national governments and responsible to the Community, plays a central role. As the executive of the Community, it ensures application of the common rules and develops their interpretation, subject to review by the Court of Justice. On the other hand, it gives the main impulse towards economic integration, submitting proposals for common rules and a common policy.

In this activity, it is backed by the Parliamentary Assembly, which consists of members of the national Parliaments. Indeed, the Commission is responsible for its action or inaction to this Assembly, which may dismiss the Commission by a two-thirds majority vote. The Assembly has set up Parliamentary Committees who hear regularly the Commission in between the sessions of the Assembly. Members of the Assembly put questions and start debates. The Commission is thus obliged to state publicly its positions on all the issues raised by the establishment of the Common Market. This has proved to be a powerful incentive for action and initiative on the part of the Commission.

The Assembly has no legislative power. But it must give advisory opinions prior to adoption of the most important regulations to be issued by the Council of Ministers. It has been taking this task very seriously, going into details and suggesting numerous amendments to the proposed regulations submitted to it.

The influence of the Assembly is mainly based on the fact that its members vote according to their political opinions and not according to their nationality. The position of the Demo-Christian group, for instance, will therefore be discussed and fought for throughout the six countries, and exercise pressure on the common institutions as well as on the national governments. Nevertheless, the Assembly should be strengthened as a political institution of the Community. It is hoped to reach that aim by choosing members of the Assembly by means of a direct election by the peoples of the six countries. With this direct election, which would need to be based on a publicly discussed platform of each political group, more influence—and perhaps even a legislative power—could be acquired. Proposals will soon be made in that direction by the Assembly to the Member-States.

In the present situation, the political power remains mainly vested in the national governments. All important issues of the Community have to be decided by the Council of Ministers in which sits a member of the government of each Member-State. It must be stressed that this Council acts as an Institution of the Community and not as a mere conference of six independent States. It follows the rules of the Treaty and must achieve the objectives of the Community. Moreover, the Commission participates in all the discussions of the Council of Ministers and exercises a strong influence over its decisions. Indeed, the Council must discuss on the basis of proposals submitted by the Commission, and can only amend such proposals by unanimous consent, whereas it can adopt them in many cases by a mere majority vote. In fact, decisions have already been taken by the Council against the will of some national governments and in agreement with the Commission's proposals. This device ensures the predominance of common interest over purely national views.

Following this procedure, the Council and the Commission make together the common policy, and exercise a quasi-legislative power in laying down the common rules necessary to implement the basic provisions of the Treaty.

The law-making power must be used within the limits and conditions set up in the Treaty. The acts of the Institutions can be referred to the Court of Justice of the Community if they are believed to violate the disposition of the Treaty. Up to now, no case has been brought before the Court on this ground within the Economic Community.

THE IMPACT OF THE COMMON MARKET ON THE OUTER WORLD

The establishment of a Common Market and the setup of a common governmental machinery in the field of economy aim primarily at European integration. Though as yet limited to economy, this undertaking is a great step forward towards European unity. The Common Market indeed does not only give to the six countries concerned—Belgium, Netherlands, Luxembourg, France, Germany and Italy—a better chance for prosperity and economic development; it also provides for an enduring basis for peace between long divided nations, and primarily for a Franco-German reconciliation.

But, while doing so, the Common Market also affects the outer world. When finally achieved, the Common Market will concern 170 million consumers and become the second world producer and the largest world trader. Business as well as Governments without the Community are directly interested in the creation of such a powerful economic entity.

On the one hand, a large market in a now prosperous Western continental Europe, with an increasing standard of living and therefore increasing needs, and with a skilled labour, is worth being prospected. Enterprises located inside the Community will benefit by the advantages of the Common Market and share in the economic development of an active area.

On the other hand, the external policy of the Community is of great importance for the interests of governments and business located outside the Common Market. Facts have already shown the liberal and cooperative views of the Community in international matters.

The establishment of a common external tariff is bound to be one of the great issues of the Community, as it has been one in the American Federation or in any group of nations gathering countries interested in a low tariff, and other countries interested in a fair amount of protection. Indeed, within the European Community, the Benelux countries, and partly Western Germany, are in favor of a low tariff while France and Italy have been protectionists for the past decades. But one of the first results of the Common Market has been to bring the protectionist countries to face the prospect of competition and get ready for it. The recent evolution of France is peculiarly striking. Having reorganized its own finances, France has now liberalized its external trade. It is beyond doubt that this new trend has been directly connected with the obligations accepted under the Common Market Treaty.

Bound to become competitive, and at the same time enabled to do so within a large market, the countries of the Community are prepared to follow a liberal trade policy vis-à-vis the outer world. In fact, accepting the views of the Commission, the European Community has answered favorably your Government's proposal to negotiate this year in GATT a significant reduction of tariffs. Moreover, the Community has announced that it would, after those negotiations, initiate a new step toward lowering tariffs.

The liberal tariff policy of the Community is followed on a non-discriminatory basis. Though the benefit of the Common Market is counter-balanced for the Member-States by specific obligations which are not assumed by non-Member Countries, the Community has extended to all third countries with but few limitations the reduction of tariffs that took place on January 1st 1959. It is presently contemplating a measure of the same kind

for the new reduction of tariffs to take place on July 1st 1960. This attitude avoids discriminatory effects not only vis-à-vis the other European countries, but also vis-à-vis the dollar zone countries.

Together with this liberal trade policy, the Community seeks to promote economic association with the outer world. Negotiations have been opened with Greece and Turkey with a view of concluding an association agreement which might lead eventually to full membership of these countries in the Community after a transitional period. A special association with the overseas territories linked with the Member-States has been provided for in the Treaty itself. Negotiations are contemplated with overseas independent countries. By means of these associations, the Community participates in the effort of economic development of European and non-European less-favored countries.

It is in the light of this external policy that the relationship between the Community and the "Outer Seven" European countries led by the British should be considered. Some people, particularly in Great Britain, seem to fear that the Common Market might lead to a split in Europe. There is no economic ground for such fear. Bearing in mind the main political issues of Europe, the six countries of the Community have chosen the method of integration, while the outer seven still stick to mere trade agreements excluding political commitments. But this difference in method leads to no difference in aims. A freer world trade is the objective of both, and the Community for its part has taken steps that show it.

There are almost no more significant problems of quotas in European trade. As to tariffs, the measures adopted by the Community have practically eliminated any discrimination. In fact, the trade of Great Britain with the Six has greatly increased since the Common Market has come into operation. As far as commercial policy is concerned, the only basic difference between the Common Market policy and a European Free Trade Area is that in the latter each European country would remain free to fix its own tariffs and follow a separate way, while the Common Market

countries are bound to follow a common policy. The obligations undertaken in the Treaty as well as the balance of interests within the six countries leads this common policy to be liberal, as facts have shown. Within a mere free trade area, some European countries at least might be tempted to follow a less liberal policy towards the non-European world. This would result in a preferential European zone discriminating against trade with the dollar zone. But if the Free Trade Area countries extended the European preference to the outer world, what would be the difference with the low tariff policy worked out in GATT that your country and the European Community support together?

In reality, if there are no economic grounds for a split between the Six and the Seven there are on the contrary many grounds for a close cooperation in their external policy. The Community, as well as the other European countries, have to face the same problems: the balance between East and West, participation in the development of the European and non-European underdeveloped countries, full modernization of the Atlantic countries. As far as these basic issues are concerned, a close common interest binds together the Western European countries, as well as your own and Canada. It is the reason and meaning of the new Atlantic cooperation which has recently been started. It is in the frame of that broad joint policy that the Six and the Seven are going to act together. This will make clear that there is no European quarrel to fear, but a joint contribution of Europe to the world problems to provide.

It will also make clear that this European contribution would be made impossible, as it has been in the past, if a peaceful and prosperous Common Market does not unite and develop long divided nations of Continental Europe. Whether it be for their own sake or for that of the world, these nations can no more afford to be absorbed in their traditional disputes. They must now look in their common future. To achieve this objective is the real meaning of the European Community. We are all closely concerned with the full success of this undertaking.

Securities Trading and Fee Sharing Under Chapter X of the Bankruptcy Act

By RICHARD V. BANDLER

In over twenty years since the enactment of Chapter X[1] there have been significant developments in many aspects of reorganization law and the Securities and Exchange Commission has been a principal actor in much of that history.[2] This article will consider some problems and pitfalls in Chapter X proceedings arising out of (1) trading in securities as that may affect allowance of compensation and (2) fee-sharing arrangements. No attempt will be made to cover the entire field, but rather particular areas and some of the underlying policies and considerations will be discussed.

I. *SECURITIES TRADING AND ALLOWANCE OF COMPENSATION*

A. IN GENERAL

The provision of Chapter X dealing with the effect of transactions in the debtor's securities upon allowances is Section 249. It is one of a number of provisions of Chapter X, which was enacted in 1938 as a broad reform program in the field of corporate reorganization. Studies made by the Commission, pursuant to authorization of the Congress under the Securities Exchange

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Editor's Note: The paper published here was delivered by Mr. Bandler at a meeting sponsored by the Section on Banking, Corporation and Business Law, John R. Raben, Chairman. Mr. Bandler is Chief, Branch of Reorganization, New York Regional Office, Securities and Exchange Commission.

The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author's colleagues upon the staff of the Commission.

1 11 U.S.C. 501 *et seq.*

2 Under the Section 208 of Chapter X the Commission appears in proceedings on its own motion or at the request of the judge; the Commission has no right to appeal.

Act of 1934,[3] showed that serious conflicts of interest had arisen between those in representative and fiduciary capacities and the persons whom they were representing arising from transactions in securities by the fiduciaries. In its report the Commission pointed out that while some courts had imposed penalties based upon general trust principles, notably in the Southern District of New York in the reorganizations of *Paramount-Publix Corporation* and *Republic Gas Corporation*,[4] "Section 77B [the predecessor of Chapter X] contains no express mandate requiring courts to adopt this enlightened approach to the trading problem, nor have the courts pursued any rigid and consistent policy in this respect."[5] Accordingly, dealing specifically with committees, the Commission expressed the view that "The vicious situation which has arisen as a result of trading by committee members calls for complete outlawry and prohibition of such practices. Anything short of that will result in too great concessions in the interests of expediency; too dangerous recessions from the ethical and moral requirements for trustees and fiduciaries.[6] . . . Such reform measures will go far towards restoring in this field some of the ancient ethical standards for trustees or fiduciaries."[7] In making a particular recommendation with respect to amending Section 77B, the Commission said: "Those who have purchased or sold securities in contemplation or after the commencement of the proceeding should not be allowed compensation or reimbursements for expenses from the estate."[8]

The bill introduced in the House of Representatives in April 1937 provided first, quite simply, that any person seeking compensation or reimbursement was required to file an affidavit show-

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[3] Securities and Exchange Commission, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1936–1940) ("Protective Committee Study"), which was submitted in eight parts.

[4] *In re Paramount-Publix Corporation*, 12 F. Supp. 823 (1935), rev'd on other grounds 83 F. 2d 406 (C.A. 2, 1936); *In re Republic Gas Corporation*, 35 F. Supp. 300 (1936).

[5] Part II, *Protective Committee Study*, *supra*, n. 3, at 348.

[6] *Id.* at 349–50.

[7] *Id.* at 351.

[8] Part I, *Protective Committee Study*, *supra*, n. 3, at 901.

ing the claims or stock purchased, acquired or transferred in contemplation of or during the proceeding, and second, that no compensation would be allowed to one who had so purchased, acquired or transferred securities. This provision was presented to the House of Representatives as "a step toward the codification" of the *Paramount* and *Republic Gas* decisions. Commissioner (now Supreme Court Justice) William O. Douglas pointed to the "administrative difficulties in determining in a particular case whether or not actual inside information was used" and the Commission's recommendation "that the best practical way of doing it was to broaden the base a little bit and establish a rule of thumb."[9] In a later revision of Section 249, while the first part requiring the filing of an affidavit remained the same, the denial of compensation was limited to committees, attorneys or other persons acting in the proceeding in a representative or fiduciary capacity—and in this form the section was passed by the House of Representatives. The fact that attorneys were named specifically is flattery in a sense since presumably it reflected the important role played by the attorney in the reorganization process.[10]

When the bill came before a subcommittee of the Senate Judiciary Committee it was pointed out that acquisitions and transfers might occur, by bequest for example, which while not purchases or sales, would act to deprive an applicant of compensation. The National Bankruptcy Conference proposed that the section be amended to provide for "consent and approval of the court." It was pointed out, however, that this would empower the judge completely to disregard and nullify the intent of the section.[11] The Commission then suggested substantially the language in which Section 249 was enacted, *i.e.*, that no compensation would be allowed a committee, attorney or other person acting in a representative capacity who, after he had assumed to act in that capacity, had purchased or sold securities or "by whom or for whose account" securities have "without the prior consent or

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9 H. Hearings on H.R. 8046, 75th Cong., 1st Sess. (1937) 184.
10 See Part II, *Protective Committee Study, supra*, n. 3, at 519–522.
11 S. Hearings on H.R. 8046, 75th Cong., 2d Sess. (1937–38) 80–81.

subsequent approval of the judge *been otherwise acquired or transferred.*"[12] While it seemed that the framers at the time intended that "otherwise acquired or transferred" was to mean something different from "purchased or sold," there has been significant litigation, some recently to which I shall refer, with respect to this provision.

The Commission's interest in Section 249, quite obviously, did not cease with its enactment, for without alert watchfulness and rigorous application the intent of the provision could be frustrated. Thus, throughout the years the Commission has been active in proceedings involving its application and has participated in most proceedings on the appellate level;[13] the Commission's Annual Reports, with few exceptions, discuss Section 249 problems and the position taken by the Commission. I must note here that the Commission has often felt quite lonesome in this area; ofttimes it is the only party to a proceeding to raise the question of disqualification. Attorneys and other parties are content to sit back and allow the Commission to do the necessary job, apparently feeling little responsibility either as parties to the proceeding or as members of the bar. I can only state my view that Section 249 is as much a part of Chapter X as, for example, Section 241–243 under which applications for fees are made; and Section 249 is no more the Commission's private preserve than those sections are the exclusive interest of applicants.

For the most part, Section 249 has been rigorously applied by the district and appellate courts.[14] The disqualification does not rest upon trading, *i.e.*, buying *and* selling, but will result from either a purchase *or* a sale and a single transaction will suffice to invoke the bar of the statute.[15] It has been held that among the

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[12] *Id.* at 124–125; 83 Cong. Rec. 8703 (75th Cong., 3rd Sess., June 10, 1938).

[13] Although the Commission has no right under Chapter X to initiate appeals it can and does participate as a party in appeals taken by others. See *e.g.*, *Scribner & Miller* v. *Conway*, 238 F. 2d 905 (C.A. 2, 1956).

[14] Allowance appeals are by leave of the Court of Appeals. See Section 250 of the Bankruptcy Act; *Dickinson Industrial Site, Inc.* v. *Cowan*, 309 U.S. 382 (1940).

[15] *In re 188 Randolph Bldg. Corp.*, 151 F. 2d 357 (C.A. 7, 1945); *In re Arcade Malleable Iron Co.*, 35 F. Supp. 461 (D. Mass., 1940); *In re Norwalk Tire & Rubber Co.*, 96 F. Supp. 274 (D. Conn., 1951).

proscribed securities are those of subsidiaries as well.[16] To be covered by the statute an attorney need not appear for a committee; appearance for an individual will suffice.[17] Transactions after an attorney has assumed to act in that capacity, although as yet he may not have acted in the proceeding, will bar him from a fee.[18] And an attorney who traded while he appeared in one capacity was denied compensation for services rendered later in the proceeding in another capacity.[19] Also, an attorney whose law partner engaged in transactions in the securities of the debtor was barred from compensation even though the purchases had been made at prevailing market prices in open market transactions.[20]

In brief, the purposes for which the section was enacted have been borne in mind. It has been recognized that "those who volunteer their assistance in the expectation of compensation under the Act must be deemed to do so subject to the rigid conditions which the Act imposes."[21] And the Court of Appeals for the First Circuit has stated:

> "The existence of good or bad faith, the fact that there is, on the face of the transaction, a profit or a loss, is immaterial. No approval by the judge can alter the situation. It is doubtless true that the statute, thus construed, may work a hardship in some cases . . . but such sporadic cases are inconsiderable compared to the large object sought to be achieved by the law, which is to fix a standard of conduct by persons acting in fiduciary capacities, in these cases, so high as to prevent any possible clash between selfish interest and faithful performance of duty."[22]

B. TRANSACTIONS BY RELATIVES

The Commission has with regularity urged the view that a transaction by one closely related to the attorney or fiduciary will serve to bar him from compensation. It has argued that any other

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16 *In re Midland United Co.*, 64 F. Supp. 399 (D. Del., 1946), aff'd 159 F. 2d 340 (C.A. 3, 1947); *In re Central States Electric Corp.*, 206 F. 2d 70 (C.A. 4, 1953).

17 *In re 188 Randolph Bldg. Corp., supra*, n. 15.

18 See *In re Equitable Office Building Corp.*, 83 F. Supp. 531, 562 (S.D.N.Y., 1949); *In re Cosgrove-Meehan Coal Corp.*, 136 F. 2d 3 (C.A. 3, 1943).

19 *In re Reynolds Investing Co., Inc.*, 130 F. 2d 60 (C.A. 3, 1942).

20 *In re Los Angeles Lumber Products Co., Ltd.*, 37 F. Supp. 708 (S.D. Cal., 1941).

21 *In re Norwalk Tire & Rubber Co., supra*, n. 15 at 277.

22 *Otis & Co.* v. *Insurance Bldg. Corporation*, 110 F. 2d 333, 335 (C.A. 1, 1940).

approach could lead to widespread abuse by applicants for it would permit the easy circumvention of trading restrictions; and that to impose upon the Commission the burden of proving an applicant's direct beneficial interest in such a situation would be tantamount to a denial of its objection. The courts, however, have expressed differing viewpoints on the subject.

In the *Equitable Office Building Corporation* proceeding, in the Southern District of New York, it was shown that the applicant, an attorney, had divulged vital information to his brother-in-law on the basis of which the brother-in-law had engaged in transactions in the debtor's stock with the applicant's knowledge. The Commission urged, among other grounds, that these transactions by the brother-in-law invoked the absolute bar of Section 249 and the district court agreed. On appeal, however, the Court of Appeals viewed the matter differently.[23] It saw the action of the applicant as a breach of trust on the basis of which the court could reduce the amount of his fee or, indeed, extinguish it completely. As for Section 249, the court held that the objectors (in that case the trustee and the Commission) had the burden of showing that the applicant had an interest in the relative's transactions; since they did not sustain the burden the section did not apply.[24]

Thereafter in *Nichols* v. *Securities and Exchange Commission*,[25] the Court of Appeals for the Second Circuit again expressed itself on the subject of the extent to which applicants may be affected by the transactions of relatives. That case arose under Rule 62(g) promulgated pursuant to the Public Utility Holding Company Act of 1935,[26] which rule, broadly speaking, is the counterpart of Section 249. Involved were transactions by the wife and daughter of one applicant and the sister of another, all apparently engaged in without the applicants' knowledge. The Commission denied compensation. The court equated Rule 62(g)

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23 *Berner* v. *Equitable Office Building Corp.*, 175 F. 2d 218 (C.A. 2, 1949).

24 For a critical discussion of this holding see Ferber, Blasberg and Katz *"Conflicts of Interest in Reorganization,"* 28 Geo. Wash. L. Rev. 319, 377–9 (1959).

25 211 F. 2d 412 (1954).

26 17 C.F.R. 250.62 (1949); 15 U.S.C. 79k, *et seq.*

with Section 249 and held basically that compensation would not be denied where the applicant "is ignorant of his relatives dealings." In the course of its decision the court went on to express fairly broad views on the subject. It characterized the Commission's contentions as "a revival of the unitary liability of the archaic sib . . ." and stated that "In modern times a man's wife is independent economically, and her profits are as a little his as are his neighbors'."[27] Also, it apparently imposed in this situation, where a wife and daughter were involved, the test which it had applied in the *Berner* case, *i.e.,* had the objector shown that the applicant had a beneficial interest in the transaction.

This situation arose recently in the reorganization of *Third Avenue Transit Corporation,* in the Southern District of New York. In making its recommendations for allowances the Commission urged that an attorney whose wife had sold bonds of the debtor with his knowledge should be denied a fee. It showed that the attorney was at all times aware of the situation, had in fact transmitted the securities to the broker in consummation of the sale, and had received and deposited the proceeds of the sale to his wife's account. Further, the loss on the sale had been applied on the joint income tax return filed by the husband and wife.

In support of its view, the Commission pointed to decisions in the Third and Fourth Circuits and in district courts holding uniformly that a transaction by a wife with the knowledge of the applicant will bar a fee.[28] It distinguished the *Berner* case on the basis of the relationship, *i.e.,* wife as against brother-in-law, and the *Nichols* case on the basis of knowledge. In contrast to the view expressed in the *Nichols* case, the Commission pointed to the statement by the Court of Appeals for the First Circuit in *S.E.C.* v. *Dumaine,* 218 F. 2d 308 (1954), which also arose under Rule 62(g), that "as a practical matter an economic benefit to a wife is indirectly an economic benefit to a husband, at least when hus-

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27 211 F. 2d at 416.

28 *In re Midland United Co., In re Central States Electric Corp., supra,* n. 16; *In re Inland Gas Corp.,* 73 F. Supp. 785 (E.D. Ky., 1947); also *S.E.C.* v. *Dumaine,* 218 F. 2d 308 (C.A. 1, 1954) under Rule 62(g).

band and wife are living together as a family unit . . ." (218 F. 2d 315), a somewhat more realistic view even in our "modern times."

The district court granted compensation.[29] It concluded that the *Berner* and *Nichols* decisions imposed upon the objector—the Commission—the burden of showing a beneficial interest and that no conclusive presumption of beneficial interest existed. It then went on, as the court had in the *Berner* case, to consider the matter from the viewpoint of a breach of trust and concluded that there had been none.

The Court of Appeals reversed. It stated that the language of the *Berner* and *Nichols* cases "on which the court below relied, is perhaps broader than those decisions warrant." It found the applicant disqualified "on the reasoning of the . . . decisions" in other circuits cited by the Commission, including the *Dumaine* case.[30]

It would appear clear on the basis of this latest determination that transactions in securities by the spouse of an applicant with his knowledge sufficiently raises a presumption of beneficial interest in the applicant so as to disqualify him from compensation. For one examining into the propriety of a fee, this is indeed a welcome result; the investigative areas to be covered and techniques to be employed in discovering the extent to which each spouse has a beneficial interest in the assets of the other—let alone the intangibles—are too much to contemplate. Also it would seem from the reasoning of the *Dumaine* case, upon which the Court of Appeals relied, that the same would apply to transactions by all members of the applicant's immediate household. Where, however, the relative is not such a member, presumably the burden would be upon an objector to show something more than the mere existence of the relationship.

When there is no knowledge on the part of the applicant—the transaction by a non-member of the applicant's household would

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29 *In re Third Avenue Transit Corporation*, CCH Bankruptcy Law Rep. ¶ 59165 (1958). The district judge in the proceeding sat on the panel of the Court of Appeals which decided the *Nichols* case.

30 *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea*, 266 F. 2d 862, 868 (C.A. 2, 1959), *cert. den.*, 80 Sup. Ct. 120 (1959).

not appear to disqualify. Where, however, lack of knowledge of the transactions by a member of the applicant's immediate household is asserted, I would again urge that unless such transactions are disqualifying, a wide avenue for evasion is open. This view appears more nearly to accord with the broad purpose of preventing the use of insider information intended by the Congress in the enactment of Section 249.[31] In light of the intimacy of the relationship among the members of the same household, the burden of demonstrating knowledge should not be placed upon an objector. And, the attorney or fiduciary is in a good position to avoid all problems by advising members of his family to refrain from transactions in the particular securities.

C. THE INDIVIDUAL SECURITY HOLDER AND HIS ATTORNEY

It has been suggested that Section 249 may apply to the individual security holder who appears and acts in the proceeding but who does not assume to act as a representative based on the theory that to receive compensation from the estate for a contribution one "incurs concomitant obligations and responsibilities and occupies at least a representative if not a fiduciary position."[32] Some weight is lent to this view by statements of the Supreme Court. Thus, in the *Dickinson* case the Court said "Fee claimants are either officers of the court or fiduciaries" and in *Brown* v. *Gerdes*, "in all cases persons who seek compensation for services or reimbursement for expenses are held to fiduciary standards . . ."[33] On the other hand, it has been urged that Chapter X in its liberal provisions for the appearance of individual creditors and stockholders in person or by counsel, including their right to be heard on all matters and to apply for compensation for contributing services,[34] points to a democratization of the reorganization process; thus, an individual security holder who has not

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[31] For a recent exposition of this view see Ferber, Blasberg and Katz, *supra*, n. 24, at 376–7.

[32] Note, 18 N.Y.U.L. Rev. 399, 475 (1941).

[33] *Dickinson Industrial Site, Inc.* v. *Cowan*, 309 U.S. 382, 388 (1940); *Brown* v. *Gerdes*, 321 U.S. 178, 182 (1944).

[34] Sections 206, 209 and 243.

overtly assumed representative status would tend to be discouraged from putting forth the effort needed to make a contribution if a casual transaction would disqualify him from compensation.[35]

While no court has gone so far as to disqualify the individual security holder, as such, where he has dealt in the debtor's securities, it appears clear that courts have looked upon such applicants strictly, seeking to find if they have not passed over the line to the status of a representative. Concededly, it is not the usual situation for an individual security holder to appear, trade in the securities and seek compensation; and usually such person occupies a somewhat more significant position than that of merely a security holder. In *Finn* v. *Childs*,[36] while the Court of Appeals for the Second Circuit took note of the differing views of Section 249 just stated, it declined to go as far as to hold (as had been urged by the reorganized company) that any individual who had traded should be barred. It did hold that, while the persons there concerned had formally professed to be appearing solely for themselves, they had molded a large group of security holders whom they, in fact, represented and this pattern of activity had constituted them fiduciaries within the meaning of Section 249. Also, in *Young* v. *Higbee*[37] the Supreme Court held that security holders who appealed individually from an adverse determination to their class did so on behalf of the class and therefore represented it and owed it fiduciary obligations and that sums derived on a sale of their securities in excess of market price in connection with the abandonment of their appeal thus belonged to the entire class. And in a subsequent proceeding it was held that Section 249 would bar these holders from charging their expenses, including legal fees on the appeal, against the proceeds of the sale of stock.[38]

As for the attorney for the individual security holder, his own transactions in the debtor's securities would of course bar him.[39] Nor may he avoid the statute by having the client apply for the

35 6 Collier, Bankruptcy 4594 (14th ed. 1947).
36 181 F. 2d 431 (1950).
37 324 U.S. 204 (1945).
38 *Young* v. *Potts*, 161 F. 2d 597 (C.A. 6, 1947).
39 *In re 188 Randolph Bldg. Corp., supra*, n. 15.

fee as an expense.[40] A more interesting question is, does the purchase or sale of securities by the individual security holder bar his attorney from a fee. Some courts have dealt with this problem.

In *In re Mortgage Guarantee Co.*,[41] it was held that where the client had engaged in "certain transactions, though relatively small," the attorney was not barred from a fee. In *In re Inland Gas Corporation*[42] a group of individual security holders engaged counsel to participate in the so-called "interest on interest" question. Along with others, counsel was successful. The clients had actively dealt in the debtor's securities and had in fact paid the attorney out of their profits; any fee allowed by the court was to be in reimbursement to the clients. On the Commission's recommendation, the court refused to allow a fee to the attorneys, holding that the clients should properly bear the expense out of their profits and that the benefit to the estate was merely collateral. The court found that the "participation [of the clients] in the proceeding through their attorneys merely constituted an effort to promote their speculative venture." Parenthetically, it can be noted that the clients had also applied for a fee; while their application was denied for failure to file the affidavit required by Section 249, the court nevertheless went on to find that they had probably constituted themselves as representatives within the meaning of Section 249.

In the Second Circuit, in *Silbiger* v. *Prudence Bonds*,[43] the court refused to deny compensation to two sets of counsel whose clients "bought and sold bonds . . . indiscriminately from time to time as it seemed to them to offer opportunities for speculative profit." The court relied upon the opinion in *In re Mortgage Guarantee Co.* where relatively small transactions had taken place. It noted that while one client had agreed to pay his attorney, the other had not. In reliance upon the *Inland* case, it suggested the possibility that where there was an agreement, recourse

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40 *In re Arcade Malleable Iron Co., supra*, n. 15.
41 40 F. Supp. 226, 238 (D. Md., 1941).
42 *Supra*, n. 28, at 792.
43 180 F. 2d 917, 922–3.

might be had against the client on the theory that the client who might have assumed a fiduciary status had been benefited from the allowance to the attorney. In an application to the Supreme Court for a writ of certiorari on another aspect of the case, in which the Commission joined, *amicus curiae,* the view was expressed by the Commission that the Court of Appeals "went too far in suggesting that attorneys' allowances are not at all affected by their clients' trading activities."

It seems to me that to a certain extent the opportunities improperly to profit from inside information during a proceeding may be minimized. There are those who appear in a proceeding as representatives, against whom the sanction clearly may be applied; and others appear without assuming a fiduciary status. The distinction should not be overlooked. Thus, the fiduciary may be allowed to participate in all phases of the proceeding including those of a non-public nature; the non-fiduciary should for the most part be limited in his participation to the public proceeding. Where, as in the *Childs* case, the security holders assume a larger role, participating actively in the plan promulgation and in other activities not generally open to public security holders at large, they may take on fiduciary obligations to the entire class with all the attendant implications. As the court said (181 F. 2d at 441):

"Large stockholders have a perfectly legitimate right to attempt to shape a reorganization in the manner they think most desirable. And they have an equally legitimate right to trade in the securities of the debtor during the reorganization. But when they do, and thus embrace an opportunity to profit from their knowledge of the course of the reorganization, they forfeit their right to be compensated for their activity from the estate."

So too, it seems to me that the attorney for the individual security holder, who may owe an obligation for the disclosure of information derived from the proceeding, should to a great extent be confined to the public aspects of the proceeding. The distinction suggested by the court in the *Silbiger* case between the attorney, on the one hand, who has an agreement for his client to pay him a fee and the attorney, on the other hand, who has no such agreement, appears to place greater emphasis upon

assuring the attorney his compensation than upon the basic policy involved. Rather than the existence of an agreement with the client, it seems to me that the nature and existence of the client's activities should be the compelling factor. Thus, if in fact, as in the *Inland* case, the security holder appears through counsel and participates principally in order to buy and sell securities for profit, then properly the attorney should be denied a fee even if, as in that case, the attorney is ignorant of the client's activities.[44] On the other hand, if the client's securities transactions are relatively few, do not appear to be a material factor in the participation in the proceeding and the attorney has no knowledge, then the client's trading should not affect the attorney's compensation. Here too, we must be aware of the intimate relationship enjoyed by attorneys and clients; and prudence might well dictate that the client be advised that if the attorney is to look to the estate for a fee there should be no transactions in the securities.

D. SECURITIES "OTHERWISE ACQUIRED OR TRANSFERRED"

As noted above, Section 249 provides for denial of compensation to one who has purchased or sold "or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred." What transactions may receive the approval of the court and what transactions may not? In reliance upon this provision applicants have sought judicial approval of sales and purchases of securities contending that the statute grants the judge such broad power.

In *Otis & Co.* v. *Insurance Building Corporation*[45] the Court of Appeals for the First Circuit analyzed both the face of the statute and the legislative history, generally as set forth above, and concluded that the power to approve was limited to securities which were "otherwise acquired or transferred"; sales or purchases represent an absolute prohibition to compensation, while

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[44] *Supra*, n. 28 at 792.
[45] *Supra*, n. 22.

securities "otherwise acquired or transferred" represent a bar unless the transaction is approved.[46]

In the *Third Avenue* proceeding, the question arose as to the effect of a pledge and subsequent sale of securities. Counsel for a committee for adjustment bondholders was, at the inception of the proceeding, the owner of bonds of the same class. Some two years later, after having participated in the proceeding to some extent, he pledged his *Third Avenue* bonds with a bank, along with other bonds and stock, as collateral for a loan. Within a relatively few months the market value of some of the pledged securities had declined and the bank demanded, in effect, that some action be taken to place the loan in balance. The attorney conceived of the demand as a "margin call" and directed the *Third Avenue* bonds sold and the proceeds applied to reduce the loan. No disclosure of the transaction was made and in the later stages of the proceeding the attorney became quite active and participated in rendering what was characterized by Commission counsel and the court as probably the most significant single contribution to the case. When allowance time drew nigh, over five years after the bonds had been sold, the attorney applied for approval of the sale under the latter clause of Section 249.

The Commission, albeit reluctantly, recommended denial of compensation. It urged that, notwithstanding the striking service rendered by the attorney, he had sold securities and Section 249 represented a complete bar to a fee. It viewed the existence or non-existence of other assets as immaterial, but pointed out that the attorney could have satisfied the bank by any number of means including the sale of the other bonds in the bundle of collateral. The attorney argued that since the bank's demand was in effect a margin call, his sale was "involuntary" and the same as if made by the bank-pledgee; in these circumstances he urged that the court had the power to approve the transaction as not being a sale by him.

The district court denied compensation. As it viewed the sta-

[46] To the same effect see *In re Consolidated Rock Products Co.*, 36 F. Supp. 912 (S.D. Cal., 1941).

tute, only a sale *by the applicant* would represent an absolute bar; a sale for the account of an applicant in which the applicant did not participate would be approvable. Thus, sale by a pledgee pursuant to a power given by the pledgor would not absolutely disqualify an applicant. It went on to find, however, that the sale by the attorney was not tantamount to sale by the bank; in light of the existence of the remaining collateral the sale of the *Third Avenue* bonds was not inevitable.[47]

Upon appeal, while urging affirmance, the Commission respectfully disagreed with the lower court. It argued:

"Where a pledgor voluntarily and knowingly (perhaps deliberately because of the restrictions of Section 249) places his securities of a debtor in a position where the normal flux of the market will affect the margin and may cause the securities to be sold—having essentially the effect of a stop-loss order—he should be chargeable with the sale. Moreover, the pledgor may permit the loan to be defaulted and in this way cause the securities to be sold. If such a pledge and subsequent sale were deemed to be encompassed within the language 'otherwise acquired or transferred' so as to permit approval by the judge, a convenient device would be created to circumvent the objective standards of the section. The natural and logical consequences of a voluntary act are not involuntary."

The Court of Appeals affirmed. As urged by the Commission it held:

"It would seem that any disposal of securities of the debtor pursuant to a pledge arrangement instituted after the applicant had assumed a representative or fiduciary capacity in a reorganization must fall within the class of transactions absolutely prohibited. Sale by the pledgee is of course pursuant to a power of sale granted by the owner; and such a pledge may often operate in practical effect as a 'stop loss order'—an order to a broker to sell if the market value of the securities drops below a specific price. If one exercising the perquisites and receiving the benefits of ownership can thus easily avoid the statutory bar by the form chosen for the particular transaction, its deterrent effect is largely dissipated."[48]

Alternatively, the court found that the attorney could have met the demand of the bank without sale of the *Third Avenue* bonds and that, therefore, the decision to sell was his own.

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[47] *In re Third Avenue Transit Corporation*, 159 F. Supp. 440 (S.D.N.Y., 1958).

[48] *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea*, 266 F. 2d 862, 867 (C.A. 2, 1959), *cert. den.*, 80 Sup. Ct. 125 (1959).

This determination would seem to establish the law where there is a sale by a pledgee under a pledge made after the attorney or fiduciary assumed to act in that capacity. Some questions remain. What if the pledged securities are not sold, but are redeemed? In that case it would appear that since no sale or purchase had occurred, no absolute bar to compensation would exist. Even here, however, under compelling circumstances, a court could, for example, invoke general trust principles to correct an abuse by the applicant of his fiduciary obligations. And what if the pledge was made long before there is any assumption to act as an attorney or fiduciary and there is a later sale by the pledgee? It is my view, since the sale was for the account of the pledgor that it would operate to bar him.[49] Exemption of this transaction from the absolute bar of the section would necessarily rest upon the assumption that the applicant's financial situation necessitated the sale by the pledgee. Certainly, if the applicant clearly was possessed of other assets and yet permitted the pledged securities to "go down the drain" he should be deemed to have effected the sale. Should then the burden of showing the extent or degree of financial stringency when the loan becomes due be placed upon an objector or upon the judge? Should the financial stringency of an applicant ever be the basis of an excuse for a sale of securities under Section 249? It seems to me that the answer to both questions must be in the negative—otherwise courts would be required to engage in subjective tests in order to enforce the statute. What is one man's stringency may well be the other fellow's affluence. Only an objective standard, that no fee will be allowed when the sale is for the applicant's account, will suffice.

Is there then some guide as to which securities transactions are approvable under Section 249 and which are not? This is most difficult since I know of no case where an applicant has successfully sought approval of an acquisition or transfer of securities. On the basis of the legislative history and the few decided cases, however, it would appear to me that if the essence of the trans-

[49] *Cf. In re Cosgrove-Meehan Coal Corp., Supra,* n. 18.

action is commercial and the acquisition or disposition is for the applicant's account it probably should be viewed as a purchase or sale and serve as an absolute bar to compensation. If, on the other hand, it is not of the commercial variety, such as a gift, bequest or by operation of law through intestacy, then it is probably within the class of approvable transactions. And even in these cases the applicant would be prudent to present the matter to the judge for prior consent, or, if that is impractical, then for subsequent approval soon after the event.

II. *FEE-SHARING ARRANGEMENTS*

A. IN GENERAL

The practice of the sharing of compensation by attorneys in bankruptcy and reorganization proceedings is undoubtedly as old as the practice of receiving compensation. More recent, however, is the recognition that, unless strictly controlled, fee sharing arrangements tend to evil and may lead to serious abuse.

Collier puts it this way:

> "Any division of fees or other compensation represents, above all, an incentive for the applicant to claim a compensation high enough to make his own share in it a worth-while remuneration. It thereby tends toward extravagence of expenditure. Another evil is that it subjects the officer or attorney entitled to compensation to outside influences, over which the court has no control and which may effect the administration by depriving the court's functionaries of their requisite independence of judgment."[50]

And in *Weil* v. *Neary,* 278 U.S. 160 (1928), the Supreme Court struck down an agreement by an attorney for creditors to share in the compensation of the attorneys for the trustees. It held such a contract "in violation of public policy and professional ethics" (278 U.S. at 174) and stated that a finding of actual fraud was unneeded; it was not only the actual evil that was being condemned "but their tendency to evil in other cases" (278 U.S. at 173).

Several years prior to that decision the Supreme Court had

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[50] 3 Collier, Bankruptcy 1614 (14th ed. 1947).

promulgated General Order in Bankruptcy No. 42 requiring allowance applicants to swear in substance that no agreement or understanding for division of compensation exists with the receiver, trustee or bankrupt or the attorney for any of them; inability so to affirm would result in a denial of compensation. And in 1938 the principle of the General Order was enacted into law and broadened as subdivisions (c) and (d) of Section 62 of the Bankruptcy Act.[51] Section 62(c) declares that a custodian, receiver, trustee, or any attorney in the proceeding may not share or agree to share his compensation with one not contributing to it, provided that an attorney-at-law may share with his law partners or with a forwarding attorney. Section 62(d) calls for an affidavit as to all fee-sharing arrangements and provides for denial of compensation where the court finds an agreement to share in contravention of subdivision (c).

B. TRUSTEES AND RECEIVERS

In order to promote more economical administration of estates, the Commission has recommended in a number of Chapter X proceedings that trustees and receivers who are attorneys act as their own counsel, utilizing where necessary the services of their law partners or associates. It has been suggested that there may be some impropriety in the employment by trustees of their law partners or firms as counsel in ordinary bankruptcy.[52] Whether that be so or not, the fact is that in Chapter X proceedings attorney-trustees have employed their firms as counsel, pursuant to order of the court.[53]

Where trustees have employed their partners or firms as counsel they have sometimes presented separate applications and sometimes a joint application for compensation. In the *Childs Company* proceeding,[54] where the trustee was administering an

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[51] 11 U.S.C. 102(c)(d).

[52] See 3 Collier, Bankruptcy 1616 (14th ed. 1947); *In re Levinson*, 19 F. 2d 253, 256 (W.D. Wash., 1927).

[53] General Order in Bankruptcy No. 44 requires that attorneys for a trustee, receiver, or debtor in possession be appointed upon order of the court.

[54] S.D.N.Y., Docket No. 82868.

active business throughout the proceeding, it was considered desirable and proper for him and his law firm to submit separate fee applications. On the other hand, in the *General Stores Corporation* proceeding,[55] where the affairs of the estate were mainly legal as against operational, the staff recommended that a single application be filed since no real division could be made between the services of trustee and counsel.

The proviso of Section 62(c) permits an attorney-at-law to share with his law partners or with a forwarding attorney. Does this prevent a trustee who is an attorney-at-law from sharing his fee with his law partners? I do not believe so, although the contrary view has been strongly urged. Collier states that the proviso

> ". . . should not be understood to authorize a receiver or trustee, who happens to be a member of the bar, to share his compensation *qua* receiver or trustee with his law partner. The exception refers only to the fees of an attorney-at-law earned *qua* attorney."[56]

It seems to me that this interpretation of the proviso is at least open to question. It could well be argued that attorneys were exempted as a profession—the expression used is "attorney-at-law" not "attorney"—since by their very nature they are officers of the court subject to high standards under the Canons of Professional Ethics; and partnership arrangements are specifically recognized by the Canons. But, without considering the appropriateness of this interpretation as it may apply in ordinary bankruptcy, it is clear as a matter of practice that attorney-trustees in Chapter X have been permitted to share their fees with their partners and that non-attorney trustees have not been permitted to share with their business or professional partners.

As an illustration, I may point to the reorganization of *Northeastern Steel Corporation*.[57] There two trustees were appointed —one an attorney, member of a large New York law firm, and the second an accountant, member of a Connecticut accounting firm. At allowance time it was pointed out to the accountant-trustee

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[55] S.D.N.Y., Docket No. 90594.
[56] 3 Collier, Bankruptcy 1616 (14th ed., 1947).
[57] D. Conn., Docket No. 27825.

that Section 62(c) would prohibit the sharing of his fees with the members of his firm. Accordingly, his affidavit recited that he would not share his fees; the other trustee's affidavit stated that he would not share his fees except with his law partners. Also, in the *Third Avenue Transit* proceeding[58] one of the trustees was an attorney and another a partner in a stock brokerage firm; the first shared with his partners and the other did not. Of course, where a law partnership arrangement is formed clearly in order to permit other attorneys to share in the compensation of either the trustee or trustee's counsel it would appear to be a clear evasion of the intent of the statute. Experience has not shown that the practice that has been followed here, and in other regions, has resulted in any evil or abuse requiring correction.

Some questions have arisen as to sharing of fees by trustees with others than partners. Recently in the reorganization proceeding for *F. L. Jacobs Co.*[59] it became known, in connection with an application for interim compensation, that one of the trustees, an officer of a bank, intended to turn over his entire fee to the bank. It was stated that the trustee-bank officer drew a regular salary from the bank, acted in many such proceedings in both federal and state courts and turned over all his fees to the bank; we were also told that this was a regular practice in the Detroit area and that other banks and bank officers acted similarly. The Commission took the view that this would contravene both the letter and spirit of Section 62(c); it advised the trustee that it would object to the payment of any fee unless an appropriate arrangement were made under which (1) he would retain his fee, (2) the bank would free him from bank responsibility, as required, so as to permit him to devote himself to estate business, and (3) his salary at the bank would not be affected by the amount of his allowance, although it might reflect a reduction in the amount of time spent on bank affairs. Appropriate arrangements were made prior to the hearing and the objection avoided.

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58 S.D.N.Y., Docket No. 85851.
59 E.D. Mich., So.Div., Docket No. 42235.

C. JOINT ATTORNEYS

From time to time, as the situation has warranted, the Commission has made recommendations for separate fees to attorneys who have acted jointly in a proceeding where it has appeared that their fee-sharing arrangement would result in a division of compensation highly disproportionate to the services rendered or contribution made. And, without challenge, courts have awarded separate compensation in a number of proceedings following the Commission's recommendation.

The first challenge to this approach occurred in the reorganization of *Pittsburgh Railways Company*.[60] There, upon the recommendation of the Commission, the court, without opinion, allowed separate fees in proportions different from those agreed upon by the applicants. In an application for leave to appeal, the affected applicants urged that the court had no power to disturb the voluntary agreement of the parties. Although pointing out that the parties had stipulated that their agreement would be "subject to the approval of the court," the Commission strongly urged that, in any event, the broad powers of the reorganization court over allowances enunciated by the Supreme Court in *Brown* v. *Gerdes*, 321 U.S. 178 (1944), and *Leiman* v. *Guttman*, 336 U.S. 1 (1949), embraced as well the power to review agreements among counsel. In its brief it stated:

> "To hold that the reorganization court may not examine into and disregard unreasonbale or unconscionable agreements between counsel might well result in unnecessary depletion of the assets of estates in reorganization to the detriment of public investors. This is because such agreements have a tendency to produce a climate favorable to extravagant requests and excessive awards. An applicant laboring under the burden of an unfavorable percentage agreement may well overevaluate the services contributed by himself and his associates in the hope that a larger award will result in a more equitable fee for himself. Similarly, in such a situation the reorganization court is itself under pressure to award an aggregate allowance in an amount larger than it would otherwise find fair in order to assure a reasonable fee to the individual participant who has made the substantial contribution."

It also pointed out that under Sections 241–243 applicants are

[60] W.D. Pa., Docket No. 20225.

to be compensated only for services "which contributed" or "which were beneficial."

"Unless persons actually performing the services are compensated on the basis of their contributions, rather than on the basis of agreements unrelated to that factor, it cannot be expected that they will render the efficient and diligent service which the security holders they represent are entitled to receive."

After leave to appeal was denied, the affected applicants moved before a successor judge (the judge who made the awards having died) to compel the pooling of the fees awarded separately. Although feeling bound by the ruling of his deceased brother, the judge quite strongly and unreservedly stated:

"I believe that the sanctity of contract must remain untrammeled, and that any legitimate agreement, spoken or written, between lawyers is sacrosanct and should be observed without equivocation. . . ." [otherwise] "the practice of law would degenerate to the era of the Neanderthal man." [61]

Not until the *Third Avenue* proceeding did a court fully consider the subject. There an attorney who represented holders of the debtor's refunding bonds entered into an agreement with a law firm for the purpose of representing those and perhaps other refunding bondholders as petitioning creditors in the filing of an involuntary Chapter X petition. The petition was so filed and, while the firm rendered significant services during the early stages of the proceeding, increasingly the entire burden was borne by the individual attorney until, for all practical purposes, the firm was no longer active in the proceeding.

When the time approached for the filing of applications for fees, the firm insisted that the agreement provided for an equal division of the compensation and that the court had no power to disturb it in the absence of a showing of bad faith at the inception of the agreement or in its execution. Additionally, it insisted that the fee had to be allowed to it since it alone had formally appeared as attorney of record—the individual lawyer was only counsel to the firm. I shall not refer to the firm's arguments that the individual attorney would be disqualified if allowed a separate fee, but not disqualified if allowed a joint fee under the agreement.

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[61] *In re Pittsburgh Railways Co.*, 121 F. Supp. 948, 949 (W.D. Pa., 1954).

The Commission recommended separate fees. It found that the agreement between the attorneys contemplated that each would contribute fairly equally to the rendering of the services, that it was understood by the parties to be subject to the approval of the court and that, in any event, the court had ample power and should exercise it in a situation such as this. The Commission did not urge an arithemetical formula applied with rigidity; it recognized that the contribution of each participant need not be the same. Thus, one participant might contribute more in direct services and the other more in the furnishing of office facilities and over-all responsibility; but it pointed out that the responsibility, to be meaningful, must be actual and closely related to the conduct of the proceeding and not of a nebulous or hypothetical variety. As for the attorney of record argument, the Commission viewed it as a mere formality; as a matter of fact, the attorneys were at least equal associates. If the court was bound by the formalism and required to make the entire fee payable to the firm, it had the power to direct the firm to pay over the appropriate amount to the individual attorney.

Reliance was placed not only upon the broad supervising power of the reorganization court over all allowances and fees as enunciated by the Supreme Court, but also upon Section 62(c) of the Bankruptcy Act, and on Canon 34 of the Canons of Professional Ethics which provides:

"No division of fees for legal services is proper, except with another lawyer, based upon a division of service or responsibility."

The district court made separate awards. It held:

"Even if the parties had not so provided in their agreement, [*i.e.*, that it was subject to court approval] the court in a reorganization proceeding has the power to determine the amount of awards where judicial sanction of the alleged agreement would result in awards grossly disproportionate to the attorney's contribution to the estate." [62]

As for Section 62(c) the court stated:

"It would be a clear evasion of the intent of this section if the court were to sanction a fee sharing arrangement whereby an attorney, having per-

[62] *In re Third Avenue Transit Corporation,* CCH Bankruptcy Law Rep. ¶ 59259 p. 65873 (1958).

formed some service, received an allowance far in excess of that to which his contribution to the estate entitled him."[63]

On appeal, the Court of Appeals affirmed. Relying specifically on the Supreme Court cases referred to, it reaffirmed the court's power to make separate awards. While noting that the parties had agreed "upon an equal division of work as well as of compensation" it apparently found no need to refer to the fact that the parties had understood their arrangement to be subject to the court's approval.[64]

The *Third Avenue* proceeding illustrates the selective approach taken by the Commission and the courts—usually on the Commission's recommendation—to the problem of allocation of fees among joint participants. In that proceeding there were a number of groups of attorneys requesting joint compensation and in all instances the Commission examined into the fee arrangements. Where the arrangement, if followed, would allow each individual participant in the joint fee a share reasonably commensurate with his contribution, the Commission recommended a single joint fee; where, however, as I have described, the Commission found that to follow the agreement would result in grossly disproportionate fees to the participants, it made separate fee recommendations. In essence this is the Commission's approach. And in the *Third Avenue* proceeding the approach and the power to implement it were affirmed.

We've undoubtedly come a long way from the evils and abuses of the past such as reported by the Commission in the Protective Committee Study or considered by the Supreme Court in *Weil* v. *Neary*. There is not only a passive acceptance but a deep recognition that reorganization proceedings are in the nature of public proceedings and that "the punctilio of an honor the most sensitive is the standard of behavior." Whether by inadvertence or because

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[63] Id. at 65874.

[64] *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea*, 266 F. 2d 862, 866 (C.A. 2, 1959), *cert. den.*, 80 Sup. Ct. 125 (1959).

of ingenuity questions will continue to present themselves. So long, however, as we continue to approach these questions in light of the spirit in which the policies were developed, as the courts generally have, we cannot stray too far.

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